

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 ARAE-00 AID-05 CIAE-00 COME-00 EB-07

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FM AMEMBASSY LIMA

TO SECSTATE WASHDC PRIORITY 5743

INFO AMEMBASSY QUITO

AMEMBASSY SANTIAGO

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 5303

E.O. 11652: GDS

TAGS: EGEN, PINT, PE

SUBJECT: PRIME MINISTER PRESENTS ECONOMIC PACKAGE, CALLS

FOR PRODUCTIVITY, DENIES DEVALUATION POSSIBILITY

REFS: A. LIMA 5249

B. LIMA 5081

C. LIMA 4958

1. SUMMARY: DURING THREE-HOUR NATIONALLY-TELEVISED PRESENTATION, PRIME MINISTER MORALES BERMUDEZ OUTLINED GOP ECONOMIC PACKAGE TO LIMA PRESS CORPS. PACKAGE INCLUDED PUBLIC AND PRIVATE SECTOR WAGE INCREASES, PRICE INCREASES (FROM 10 PERCENT TO 35 PERCENT ON NUMEROUS ESSENTIAL PRODUCTS ON WHICH PRICES ARE CONTROLLED BY GOP). HE CATEGORICALLY DENIED POSSIBILITY OF DEVALUATION, AND CALLED SPECIFICALLY FOR GREATER INDUSTRIAL AND AGRICULTURAL PRODUCTION. HE MADE AN APPEAL TO LABOR IN ALL SECTORS FOR A "WORK CRUSADE".

PRIME MINISTER BLAMED WORLD INFLATION FOR PROBLEMS AFFECTING GOP ECONOMIC STRATEGY BUT ALSO CANDIDLY ADMITTED THAT NATIONAL PRODUCTIVITY AND CONSEQUENTLY GOVERNMENT SAVINGS HAVE BEEN INSUFFICIENT. IN SIMILARLY CANDID

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MANNER, HE ALSO ADMITTED THAT GOVERNMENT SUBSIDY PROGRAM

HAD FAILED TO BENEFIT MASSES OF POPULATION AND THAT  
GOP, FACED WITH INCREASING FOOD IMPORTS AND INCREASED  
DEFICIT, DECIDED ON NEW MEASURES.

2. MORALES BERMUDEZ EMPHASIZED THAT PACKAGE OF MEASURES  
WAS DESIGNED TO RATIONALIZE USE OF ECONOMIC RESOURCES  
AND TO MAINTAIN PURCHASING POWER OF WORKERS WHILE ALIGN-  
ING PRICES TO COSTS, THUS ENCOURAGING PRODUCTIVITY. IN  
LONG QUESTION AND ANSWER SESSION FOLLOWING PRIME MINISTER'S  
SPEECH, PRIME MINISTER FIELDDED QUESTIONS WITH AGILITY, AND  
PASSED ON SPECIFIC RESPONSES TO OTHER "PRODUCTIVE SECTOR"  
MINISTERS. IT SEEMS TO US THAT PRIME MINISTER'S STATURE  
WAS SUBSTANTIALLY ENHANCED BY FIRM MANNER IN WHICH HE  
DOMINATED PROCEEDINGS, AND BY HIS CALM AND COHERENT RES-  
PONSES TO QUESTIONS. GENERAL TONE WAS VERY BUSINESS-LIKE  
AND PRACTICALLY FREE OF DEMOGOGY AND PRIME MINISTER CER-  
TAINLY EMERGED AS PRIMUS INTER PARES. PRICE INCREASES  
COULD, HOWEVER, SPARK POPULAR DISCONTENT, PARTICULARLY  
AMONG UNEMPLOYED AND UNDEREMPLOYED WHO STAND TO GAIN LITTLE  
FROM WAGE INCREASES. END SUMMARY.

3. PERUVIAN ECONOMY BUFFETED BY INFLATION AND LACK OF  
PRODUCTIVITY AND SAVINGS: MORALES BERMUDEZ BEGAN  
PRESENTATION BY NOTING THAT SINCE FEBRUARY, GOP'S INTER-  
MINISTERIAL COMMITTEE FOR FINANCIAL AND ECONOMIC AFFAIRS  
(CIAEF) HAS BEEN CLOSELY MONITORING QUESTIONS OF IN-  
FLATIONARY PRESSURES, SUBSIDIES, AND SUPPLIES. FIRST,  
PERU HAS BEEN AFFECTED BY EXTERNAL INFLATIONARY PRESSURES  
WHICH LED TO PRICE DISTORTIONS, FOREIGN EXCHANGE DRAIN  
FOR FOOD IMPORTS, AND SUBSEQUENT REDUCTION IN PUBLIC SAV-  
INGS, PRESSURE ON GOP BUDGETARY RESOURCES, AND CONTRA-  
BAND SALES OF SUBSIDIZED FOODS TO NEIGHBORING COUNTRIES.  
THUS, GOP DECIDED ADOPT NEW INTEGRATED AND GRADUAL SOLU-  
TION, READJUSTING PRICES ON BASIC COMMODITIES, INCLUDING  
FOOD, FUEL, TRANSPORT AND FERTILIZERS (WHICH WILL CONTINUE  
TO BE SUBSIDIZED TO INCREASE AGRICULTURAL PRODUCTION). AFTER  
PRICE ADJUSTMENTS, A PRICE FREEZE WILL BE IMPOSED TO ALLOW GOP  
TIME TO STUDY EFFECTS.

4. PUBLIC AND PRIVATE SECTOR WAGE INCREASES: PUBLIC SECTOR  
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WORKERS ARE TO RECEIVE WAGE INCREASES OF S/.1,600 MONTHLY  
ACROSS-THE-BOARD. IN ADDITION, THOSE PUBLIC AND PRIVATE  
SECTOR WORKERS SUBJECT TO GENERAL LABOR LAWS, WHICH COVER  
A NUMBER OF STATE ENTITIES, WILL RECEIVE INCREASE OF S/.400  
MONTHLY. FOR THE PRIVATE SECTOR, DECREE LAW 21202 SETS  
FORTH GUIDELINES FOR COLLECTIVE BARGAINING DURING  
REST OF  
1975: (A) MINIMUM GENERAL INCREASE: S/.450 MONTHLY OR

S/.15 DAILY; (B) MAXIMUM GENERAL INCREASE: S/.1,620  
MONTHLY OR S/.54 DAILY. IN LATTER CASE, WHEN ECONOMIC  
CONDITION OF FIRM SO PERMITS, INCREASES TO S/.2,100  
MONTHLY, OR S/.70 WILL BE APPROVED. SAME D.L. ALSO  
ESTABLISHES CEILING ON NEW SALARY CONTRACTS IN THE PRIVATE  
SECTOR OF S/.840,000 YEARLY, OR S/.70,000 MONTHLY FOR NEW  
EXECUTIVES (EXISTING CONTRACTS ARE APPARENTLY UNAFFECTED).  
WAGES BEYOND THIS LIMIT WILL NOT BE CONSIDERED A COST TO  
THE FIRM, BUT MUST RATHER BE SUBTRACTED FROM PROFITS RE-  
MAINING AFTER THE INDUSTRIAL COMMUNITY HAS RECEIVED  
ITS SHARE. (COMMENT: THIS LIMIT COULD PLACE SERIOUS  
CRIMP IN ATTRACTING COMPETENT MANAGERS AND TECHNICIANS,  
BOTH PERUVIAN AND FOREIGN, TO MANAGE AND ADVISE PRIVATE  
SECTOR ENTERPRISES.) D.L. 21207 OF JUNE 26 ALSO RAISED  
MINIMUM SALARIES FOR THIRTEEN DEPARTMENTS OF PERU, INCLUD-  
ING LIMA. LIMA MINIMUM INCREASED FROM S/.3,000 TO S/.3,540.

5. PRIME MINISTER NOTED THAT BASIC PRIVATE AND PUBLIC  
SECTOR INCREASES WERE JUSTIFIED ON BASIS OF PREVIOUS IN-  
FLATION RATES, AND THAT S/.400 ACROSS-THE-BOARD INCREASE  
WAS CALCULATED ON BASIS OF A THEORETICAL MINIMUM SALARY  
OF S/.4,000. PRIME MINISTER THEREFORE IMPLIED THAT PRICE  
INCREASES WILL PROBABLY BE AT LEAST TEN PERCENT, THE FI-  
GURE HE SAID GOP HAD TAKEN AS BASIS FOR ARRIVING AT  
S/.400 FIGURE TO COMPENSATE FOR PRICE INCREASES PRO-  
MULGATED BY GOP.

6. FUEL INCREASES AND PETROLEUM PROSPECTS: PRICES OF 84 AND  
95 OCTANE GASOLINE JUMPED TO S/.15 (67 PERCENT INCREASE)  
AND S/.30 (100 PERCENT) A GALLON, RESPECTIVELY. PRIME  
MINISTER POINTED OUT THAT PETROPERU HAS BEEN RUNNING A  
DEFICIT, AND IT IS NECESSARY TO ELIMINATE SUBSIDIES ON  
THESE PRODUCTS. NEITHER HE NOR MINES MINISTER FERNANDEZ  
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MALDONADO RESPONDED DIRECTLY TO QUESTION WHETHER FULL COST  
OF GASOLINE PRODUCTS WILL BE MET BY NEW PRICE INCREASES.  
BOTH MINISTERS, HOWEVER, STATED THAT PERU'S FIRST PRIORITY  
IN PETROLEUM FIELD IS TO BECOME SELF-SUFFICIENT BY 1977  
WHEN NORTH-ANDEAN PIPELINE WILL BE COMPLETED, AND THEN,  
EVENTUALLY, TO BECOME PETROLEUM EXPORTER. BOTH ALSO SAID  
THERE HAS BEEN AN "INTERNATIONAL CAMPAIGN" AGAINST PERU'S  
OIL PROGRAM, DESIGNED TO REDUCE COUNTRY'S PRESTIGE BY  
CLAIMING THERE IS LITTLE PETROLEUM IN THE JUNGLE. (COMMENT:  
MINISTER'S STATEMENTS ARE FIRST MAJOR PUBLIC ADMISSION  
THAT PIPELINE WILL NOT BE FINISHED UNTIL 1977 AND THAT  
PERU'S PETROLEUM PROSPECTS ARE NOT YET BRIGHT ENOUGH TO  
EXPECT PERU TO BECOME PETROLEUM EXPORTER IMMEDIATELY UPON  
COMPLETION OF THE PIPELINE. WE PRESUME ATTACK ON "FOREIGN  
NAY-SAYERS" REFERS INTER ALIA TO MAY 26 OIL AND GAS JOURNAL

ARTICLE (POUCHED TO ARA/EP.)

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7. AGRICULTURAL POLICY; PRIME MINISTER LAID CONSIDERABLE STRESS ON LACK OF SUFFICIENT AGRICULTURAL PRODUCTIVITY, WHICH HE ADMITTED HAS ACTUALLY FALLEN SINCE THE AGRARIAN REFORM WAS INSTITUTED. HE SAID THAT, GIVEN LACK OF PRICE INCENTIVES TO AGRICULTURAL PRODUCERS, PRODUCTION HAS DROPPED OFF. THUS, IN AN EXCEPTION TO GENERAL DECISION TO REDUCE SUBSIDIES, SUBSIDIES WILL BE PLACED ON FERTILIZERS TO INCREASE INCENTIVES FOR FARMERS TO PRODUCE MORE AND ACTUAL COST WILL GO DOWN BY 40 PERCENT. HE THEN CALLED FOR A "WORK CRUSADE", PARTICULARLY IN AGRICULTURE. FOOD MINISTER HOYOS ALSO SAID THAT HIS MINISTRY IS WORKING ON MEANS TO REDUCE ROLE OF MIDDLEMEN IN FOOD-PROCESSING CHAIN, AND PLANS TO COORDINATE WITH REGIONAL OFFICES OF HIS MINISTRY AND LOCAL AUTHORITIES TO PURCHASE SPECIFIC FOOD PRODUCTS DIRECTLY FROM PRODUCER FOR SALE TO THE CONSUMER. HE ADMITTED, HOWEVER, THAT SOME FORMS OF CAPITALISM WILL CONTINUE TO EXIST IN PERU AND THAT IT WILL NOT BE IMMEDIATELY POSSIBLE TO ELIMINATE MIDDLEMEN ENTIRELY.

8. PRICE LEVELS: FINANCE MINISTER VARGAS GABILANO SAID THAT GOP NOW EXPECTS INFLATION RATE TO RUN TO ABOUT 30  
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PERCENT THIS YEAR (INCLUDING NEW PRICE INCREASES), BUT THAT INFLATION RATE FOR FULL FOUR-YEAR TERM OF NATIONAL DEVELOPMENT PLAN (1975-78) SHOULD DROP OFF TO 20 PERCENT ANNUALLY. PRIME MINISTER ALSO EMPHASIZED THAT AFTER PRICE AND WAGE INCREASES GO INTO EFFECT, RATE OF PRICE RISE SHOULD BEGIN TO TAPER OFF.

9. UNDEREMPLOYMENT AND UNEMPLOYMENT. TWO RADICAL JOURNALISTS, HUGO NEIRA OF "CORREO" AND PACO MONCLOA OF "EXPRESO", PRESSED MINISTERS HARD ON EFFECTS OF PRICE INCREASES ON THE UNDEREMPLOYED AND UNEMPLOYED. PRIME MINISTER GAVE INDIRECT ANSWER THAT UNDEREMPLOYMENT AND UNEMPLOYMENT ARE STRUCTURAL PHENOMENA OF ALL LDCS AND THAT BASIC CHANGES BROUGHT ABOUT BY GOP ARE INCREASING REDISTRIBUTION OF INCOME AND THEREFORE OF BUYING POWER OF WORKERS GENERALLY. (COMMENT: NEIRA'S QUESTION CAUSED THE PRIME MINISTER HIS ONLY MOMENT OF VISIBLE UNEASE AND HE RETORDED SHARPLY. NEIRA ALSO HAS A POINT, SINCE UNORGANIZED WORKERS ARE THOSE WHICH WILL PROBABLY SUFFER MOST FROM PRICE HIKEs, WITHOUT RECEIVING FULL BENEFIT OF WAGE INCREASES.)

10. REDUCTION OF SUBSIDIES: FINANCE MINISTER VARGAS GAVILANO ALSO RESPONDED TO QUESTION ABOUT SUBSIDIES, NOTING THAT DIRECT SUBSIDIES PROGRAMMED FOR 1975-76 AMOUNTED TO S/.11.8 BILLION, WHICH WILL BE REDUCED TO S/.3.8 BILLION DURING BIENNium FOR A SAVINGS OF S/.8 BILLION. (COMMENT: THIS SAVING REPRESENTS ONE-QUARTER OF PROGRAMMED GOP BIENNIAL DEFICIT, AND FIRS CLOSELY WITH COMMENTS OF IMF REPRESENTATIVE (REF B) THAT SAVINGS FROM DEFICIT WILL PROBABLY NOT BE SUFFICIENT TO GENERATE SUBSTANTIAL GOVERNMENT INVESTMENT THAT GOP HAS ORIGINALLY HOPED FOR.)

11. NO DEVALUATION: PRIME MINISTER EMPHASIZED IN HIS SPEECH THAT DEVALUATION IS TOTALLY OUT OF THE QUESTION AND THEN CITED NUMEROUS REASONS, INCLUDING INELASTIC EXPORTS, CONTROLLED IMPORTS, AND PRICE CONTROLS AS REASIVE VALUE (SEE LIMA 4658). (COMMENT: WHILE GOVERNMENTS REARELY ANNOUNCE DEVALUATIONS BEFORE-HAND, THE CATEGORICAL MANNER IN WHICH PRIME MINISTER  
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REJECTED DEVALUATION AS POSSIBILITY SHOULD REDUCE  
RUMORS THAT GOP IS ACTIVELY CONSIDERING SUCH A MEASURE AT THIS TIME).

12. CARTELS: IN RESPONSE TO QUESTION, MINES MINISTER FERNANDEZ MALDONADO LAUDED PERU'S SUPPORT FOR RAW MATERIALS CARTELS, CLAIMED THAT CIPEC WILL SOON EXPAND MEMBERSHIP TO INCLUDE VARIOUS ASIAN NATIONS, AND THAT PERU IS ACTIVE IN MERCURY CARTEL AND WILL BE DISCUSSING SILVER CARTEL WITH MEXICAN DELEGATION DUE TO VISIT LIMA THIS MONTH. MINISTER SAID THAT PERU SHOULD "IMPOSE JUST PRICES" THROUGH CARTELS ON INDUSTRIALIZED WORLD AND PRAISED PERUVIAN INITIATIVE AT HAVANA NONALIGNED COORDINATING MEETING EARLIER THIS YEAR TO WORK FOR A WORLD-WIDE RAW MATERIALS PRODUCERS ASSOCIATION. FERNANDEZ MALDONADO SAID THAT RESOLUTION EIGHT OF THE HAVANA CONFERENCE ON THIS SUBJECT WILL BE SPONSORED BY PERU DURING FORTHCOMING NONALIGNED CONFERENCE IN LIMA IN MID-AUGUST. COMMERCE MINISTER ARIAS GRAZIANI ALSO MENTIONED THAT PERU WILL CONSULT WITH OTHER LATINS ON POSSIBILITY OF MAINTAINING JUST PRICE FOR SUGAR AND IS WORKING WITH EGYPT AND THE SUDAN TO STUDY POSSIBILITIES OF A COTTON CARTEL FOR THE KINDS OF COTTON (LONG STAPLE) THE THREE COUNTRIES PRODUCE. (COMMENT: MENTION OF CARTEL POLICY FOLLOWED STANDARD GOP RHETORIC, AND WAS ONLY MOMENT WHICH VERGED ON DEMAGOGY. PRIME MINISTER TURNED CARTEL QUESTION OVER TO MINES MINISTER IMMEDIATELY. AND DID NOT SEEM PARTICULARLY INTERESTED IN SPEAKING TO THIS ISSUE HIMSELF.)

13. OTHER MEASURES: FINANCE MINISTER VARGAS GAVILANO SEVERAL TIMES EMPHASIZED NEED TO INCREASE NATIONAL SAVINGS, BUT MADE NO MENTION OF CHANGING INTEREST RATES WHICH HAVE BECOME HIGHLY NEGATIVE IN REAL TERMS. MINISTER SAID THAT NEW TAXES ARE UNDER STUDY AND WILL BE IMPOSED IN THE FUTURE, BUT NOT IMMEDIATELY, SINCE GOP NEEDS TO EVALUATE EFFECTS OF WAGE/PRICE PACKAGE BEFORE INTRODUCING SUCH MEASURES. (COMMENT: IT IS NOT CLEAR HOW THE GOP INTENDS TO PROCEED IN THIS AREA. ON THE BASIS OF THE PROGRAM AS DISCUSSED, IT APPEARS THAT HIGHER SAVINGS WILL RESULT ONLY FROM THE ELIMINATION OF SUBSIDIES, AND PERHAPS DECREASED CONSUMPTION.)

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QRM COMMENT: PRIME MINISTER MORALES BERMUDEZ CLEARLY STOOD OUT AMONG HIS COLLEAGUES LAST NIGHT AT THE FIRST AMONG EQUALS, IF NOT QUITE YET THE ACTING PRESIDENT OF PERU. ONLY ONE MINISTER AND A COUPLE OF JOURNALISTS EVEN MENTIONED PRESIDENT VELASCO'S NAME, AND IT WAS CLEAR TO ALL THAT MORALES BERMUDEZ WAS IN THE DRIVER'S SEAT.

SEVERAL WELL-INFORMED TECHNICIANS HAD TOLD US EARLIER THAT THE GOP HAD HOPED THAT PRESIDENT WOULD BE ABLE TO MAKE THE "ECONOMIC POLICY PACKAGE" PRESENTATION, BUT IS NOW APPEARS THAT HIS HEALTH DID NOT PERMIT HIM TO DO SO. IN THE EYES OF THE PUBLIC, THESE MEASURES ARE CLEARLY IDENTIFIED WITH THE PRIME MINISTER, WHO THROUGH HIS UNDERSTANDING OF ECONOMICS AND THE FORCE OF HIS PERSONALITY HAS BROUGHT ABOUT A FUNDAMENTAL CHANGE IN DOMESTIC ECONOMIC POLICY. TO US, THE PRIME MINISTER'S OPEN ADMISSION THAT PERU'S PAST POLICIES HAVE NOT MET THEIR GOALS WAS A REFRESHING DEPARTURE FROM THE USUAL GOP VERBIAGE. WHILE MORALES BERMUDEZ ADMITTED THAT WORLD INFLATION IS A PARTIAL CAUSE OF PERU'S TROUBLES, HE DID NOT CASTIGATE THE CAPITALIST WEST, BUT CENTERED HIS ATTENTION ON PERU'S LACK OF INCENTIVES FOR PRODUCTIVITY, AND MENTIONED SEVERAL TIMES THAT PERUVIANS THEMSELVES WILL BE RESPONSIBLE FOR THE FUTURE ECONOMIC COURSE OF EVENTS. HE THEREFORE CALLED FOR A "WORK CRUSADE", BUT STOPPED FAR SHORT OF ANNOUNCING THE NEED FOR A "NEW PERUVIAN MAN" WHO WOULD WORK SOLELY OR PRINCIPALLY FOR MORAL INCENTIVES ALONE.

15. THE MINISTERS' PRESENTATION LEFT MUCH TO BE DESIRED IN THE WAY OF HARD ECONOMIC FACTS WHICH WOULD PERMIT US TO CALCULATE WITH REASONABLE ACCURACY THE INCIDENCE OF PRICE INCREASES WHICH THE PACKAGE WILL BRING IN ITS WAKE. ACCORDING TO THE MINISTERS' STATEMENTS, THEY APPARENTLY ESTIMATE THAT PRICE INCREASES WILL PUSH INFLATION THIS YEAR FROM TWENTY PERCENT TO APPROXIMATELY THIRTY PERCENT. WE TEND TO THINK THAT PRICE INCREASES COULD GENERATE SUBSTANTIALLY MORE INFLATION, AT LEAST FIFTEEN PERCENT AND POSSIBLY TWENTY PERCENT OR MORE, DEPENDING ON THE MULTIPLIER EFFECT. IT IS THEREFORE POSSIBLE THAT INFLATION THIS YEAR COULD REACH FORTY PERCENT OR MORE, BUT IT IS TOO EARLY TO PREDICT WITH ACCURACY.

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IN ANY CASE, PERU HAS NOW ADOPTED THE "MORALES BERMUDEZ FORMULA" AND HE IS CLEARLY THE TARGET FOR ANY FUTURE AGITATION WHICH COULD WELL DEVELOP WHEN THE EFFECTS OF PRICE INCREASES BEGIN TO BE FELT AMONG THE GENERAL URBAN POPULATION. HIS EMPHASIS ON FLEXIBILITY, HOWEVER, COULD STAND HIM IN GOOD STEAD, AND SHOULD WIDE-SPREAD POPULACE DISCONTENT DEVELOP, IT IS POSSIBLE THAT THE GOP WOULD CONSIDER FURTHER REMEDIAL MEASURES ON THE WAGE SIDE, EVEN THOUGH THIS MIGHT MEAN SOME LONG-RANGE REDUCTION IN THE COUNTRY'S DEVELOPMENT PROJECTS.

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